

**OFT's response to the discussion paper
issued by the Council of the Law Society of
Scotland**

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OFT977

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OFT'S RESPONSE TO THE DISCUSSION PAPER ISSUED BY THE COUNCIL OF THE LAW SOCIETY OF SCOTLAND IN RELATION TO OPTIONS FOR THE INTRODUCTION OF ALTERNATIVE BUSINESS STRUCTURES

OFT's views on most of the issues raised in the Discussion Paper can be found in the Scottish Executive's Research Working Group report¹ (SE Research report) and in its Response to the super-complaint submitted to the OFT Which? (the OFT Response).²

OFT fully supports the introduction of Alternative Business Structures (ABSs) since they allow legal service providers to adapt their businesses to the most efficient model to make the market work better for consumers. ABSs are likely, in OFT's view, to produce consumer benefits such as more choice, higher quality services and lower costs.

The OFT recognizes that any changes must take account of the public interest and that, where necessary, suitable safeguards must be put in place. The need for such safeguards does not justify the current blanket restrictions.

Lifting these restrictions would not compel legal providers to change. The current business models will still be available, with firms free to choose the model that best meets their business needs.

Once the relevant provisions of the Legal Services Act come into force, lawyers in England and Wales will be working in a regulatory framework that makes provision for the possibility of access to external capital and operation through ABSs. This could place Scottish law firms at a competitive disadvantage.

¹ Report by the Research Working Group on the Legal Services Market in Scotland, April 2006.

² Response to Which?'s super-complaint July 2007, OFT 946

1. Do you think the legal services market would benefit from a move towards a LDP model?

LDPs allow lawyers from different professional disciplines (for example, solicitors and advocates) to offer legal services to clients as part of the same law practice.

Members of a LDP can share overhead costs and also benefit from risk-spreading where members of the different branches of the profession have different areas of specialisation of practice, such as advocacy, and can generate economies of scope. LDPs can also offer a broader range of legal services.

The OFT firmly believes that restrictions on forming LDPs unnecessarily inhibits legal services providers from adapting their business in a manner that best suits their clients' needs, preventing legal services providers from operating more efficiently resulting in lower fees for clients.³ It is the interest of the Scottish legal profession and, ultimately, of consumers in Scotland that such a prohibition be lifted.⁴

2. Is there any justification for requiring clients to have to instruct a firm of solicitors if they wish to instruct an advocate for a matter in the Court of Session or the High Court?

The restrictions on direct access are inefficient where a client is fully capable of instructing counsel without going through a solicitor. For such clients the requirement to use a solicitor constitutes an unnecessary cost.

A relaxation on this rule would allow advocates to compete directly with solicitors and solicitor advocates.⁵

³ OFT's response to Super Complaint, paragraph 2.4

⁴ OFT's Response, section 4.

⁵ OFT Response, section 6.6

The OFT does not consider there is any justification to the present restriction⁶. Consumers should be free to instruct advocates direct, and advocates should be free to decide whether to accept direct instructions. They will be able to ensure that when clients would be better served by instructing a solicitor they are advised to do so.

3. Is consumer choice already adequately provided for by the choice between an advocate and a solicitor advocate?

Where a client instructs an advocate of one profession to provide advocacy services and the services of a second advocate are required, the rule on 'mixed doubles' requires that the second advocate must be a member of the same profession.

The OFT believes that consumer choice is not adequately provided. The rule restricts consumer choice by unnecessarily limiting the choice of professional that best meets the consumer's needs. Consumers may also be incurring higher legal costs as a result of the prohibition on 'mixed doubles'

4. Do you think the legal services market would benefit from a move towards a MDP model?

The market would be best served by increasing the opportunities for providers of professional services to choose what business model would enable them to meet consumers' needs best.

MDPs would allow professionals from different disciplines (for example lawyers, accountants and chartered surveyors) to be able to offer a range of services to clients as part of the same practice.

OFT feels that restrictions on MDPs inhibit new entry and prevents the exploitation of possible economies of scale and scope.⁷ Legal services could benefit from efficiencies that MDPs provide. The provision of High Street

⁶ OFT Response, section 6

⁷ SE research report, paragraph 8.70

professional services under one roof, for example, should unlock potential cost efficiencies and enhance customer choice and convenience at that level of the market.

OFT has been informed by solicitors in Scotland that their clients are interested in purchasing legal services from a one-stop shop which MDPs could provide. Solicitors with whom the super-complaint team met explained that lifting the restrictions on MDPs would enable them to recruit and retain a diverse range of people with skills and talent that can enhance their business. Such changes could also facilitate different career structures and working hours for some solicitors and might broaden entry to the profession.⁸

There have been examples of parallel partnerships such as McGrigor Donald and KLegal/KPMG and between Dundas and Wilson and Andersen Legal both of which subsequently broke down. However, these were not MDPs which operated under an enabling regulatory regime. Their failure therefore is not necessarily an indication as to the possible success or otherwise of MDPs. In any event, the success or failure of particular business arrangements should be determined by the market not by *ex ante* restrictions.

5. Would the advent of MDPs be an adequate response to the demands for change from the profession and from other stakeholders

While the advent of MDPs would be an important step forward, the OFT believes that it would be better to widen the range of business structures available yet further. It considers that it should be possible for MDPs to be owned by non-lawyers so that lawyers have all the choices available to expand their businesses and funding.

Restrictions on external investment are preventing law firms from accessing capital that would allow them to expand, to take advantage of the latest technology and to compete more effectively in Scotland and with firms in other jurisdictions.

⁸ SE Research Report, Paragraph 8.29

Solicitors who OFT met during the course of work on the super-complaint expressed concern that the restrictions on outside ownership prevented them from expanding their business and from funding innovation.

Lifting the restrictions would enable those practices that wished to do so to attract talented non-legal staff with more diverse skills, such as management skills, with the possibility of ownership. This could also help smaller firms who might wish to consolidate, and thereby secure longevity.⁹ Profit margins for some law firms are reducing and that these firms need to be better managed. Outside ownership could assist with this. However, it would be no more than one available option, which would thrive or not depending on whether it met the needs of consumers of legal services. If traditional ownership models better met these needs, either generally or in particular circumstances, then there is no reason why they should not continue to be a major source of legal services.

6. What effect, if any, would allowing non-solicitor partners have on the core values of the solicitors' profession?

One of the arguments for continuing to restrict non-lawyer ownership of law firms is that lifting the restriction could conflict with the core values of lawyers (guaranteed independence, avoidance of conflicts of interests, and client confidentiality). It is suggested that generally there could be difficulties in regulating such firms and even that it could result in law firms being owned by those involved in organized crime.

The OFT recognises the importance of maintaining the core values whoever owns the firm, and that specific regulations are needed in order for law firms owned by non-lawyers to operate properly.

In England and Wales ownership of law firms will be regulated through a 'fit to own' test which might have regard to honesty, integrity and reputation, competence and capability and financial soundness. A similar test in Scotland, if introduced, should alleviate these concerns.

⁹ Also see OFT's Response, section 5.

OFT does not believe that there will be any negative impact on the core values and that these can be safeguarded. There is no basis for suggesting that non-lawyers are inherently less trustworthy than lawyers.¹⁰

7. What would the impact if any be on the Guarantee Fund and / or the Master Policy?

OFT is not in a position to comment upon whether and how the Guarantee Fund and the Master Policy may be affected. However any changes to be made to their operation should not act a barrier or deterrent to the creation of ABSs.

8. What would the effect of the creation of MDPs be on access to justice?

There are two sets of consumers who face particular challenges in accessing justice: those located in rural areas and consumers on low incomes who cannot afford legal services.

OFT feels that the creation of MDPs should improve access to justice since MDPs allow solicitors to share overhead costs with other professionals and to offer a broader range of services.¹¹ Opportunities to provide combinations especially in rural areas as well would enhance access to justice. It might even be the only way in which a range of professional services could be economically provided at all in some areas.

Solicitors have told the OFT that high street or rural practices increasingly recognise that third party ownership would enable them to extract value from their goodwill, allowing individual solicitors to exit the market, which may help preserve those firms rather than to close them down on retirement.¹²

Solicitor firms told the OFT that vulnerable clients dependent on legal aid are more likely to find their access to justice determined by the levels at which legal aid rates are set, than by the presence or absence of MDPs. That said, to the

¹⁰ OFT Response, section 5.12

¹¹ SE Research report, Paragraph 8.77

¹² OFT Response section 5.6

extent that ABSs are able to operate more efficiently than traditional business models, they would be able to cope better with constraints on legal aid rates.¹³

9. How would conflict between different regulatory codes be resolved?

There are likely to be instances where the rules of the respective professional bodies would need to be amended in order to reflect new responsibilities for providers operating in ABSs. OFT considers that the relevant professional bodies are best placed to resolve any conflicts.

10. Do you think the legal services market would benefit from a move towards a shareholding model?

Legal providers should be free to adopt this business structure if they feel it best suits clients' needs and creates efficiencies, subject to any necessary consumer safeguards. The OFT has no views on the inherent value of any particular ownership model. Different models will suit different circumstances. The normal working of the market should determine the balance between them.

11. How would it be possible to ensure that control of a solicitor's practice with non-solicitor shareholders could remain with the solicitor directors?

OFT is not aware of any evidence to support the proposition that control must stay with the solicitor directors. In any event this is an issue to be determined by the authority entrusted with the regulation of such practices. One solution may be to appoint a Head of Legal Practice as stipulated in the Legal Services Act covering England and Wales.

12. Should any limit be imposed on the proportion of shares which could be owned by any single external shareholder?

This is an issue to be determined by the authority entrusted with the regulation of ABSs provided that any limitation is pro-competitive (or at least not anti-competitive) and proportionate.

¹³ OFT Response section 5.14

13. Should any minimum proportion of shares still require to be owned by solicitors or registered foreign lawyers?

See the answer to 12 above.

14. What, if any, requirements should there be for non-solicitors to satisfy by way of 'fitness to own'?

Regulating ownership of law firms can ensure that only appropriate persons own law firms. In England and Wales ownership of law firms will be regulated through a 'fit to own' test which is to have regards to honesty, integrity and reputation, competence and capability and financial soundness. A similar test could be considered for Scotland.

15. What, if any, charge should be levied by the Society on external shareholders and should that be a one-off or annual charge?

OFT recognises that any costs of regulation need to be met by some form of charging mechanism. OFT does not believe that any charges which were not neutral as between different business models would be sustainable.

16. Do you think the legal services market would benefit from a move towards a non-lawyer ownership and control mode?

OFT has already indicated in answer 5 that it very much supports the introduction of the opportunity for those who wish to do so to make such a move. We have been told that some legal services providers believe it could be advantageous. However, as indicated in the answer to question 10, the OFT has no views on the inherent value of any particular ownership model. Different models will suit different circumstances. The normal working of the market should determine the balance between them.

External ownership allows lawyers to take advantage of the efficiencies which these organisational forms provide, in particular, accessing external investment to fund expansion and entry into new markets and attracting talented non-legal staff.

Solicitor firms have told the OFT that allowing lawyers and non-lawyers to operate under the same business structure could be more cost effective and provide the convenience of a one-stop shop.

OFT would expect any benefits arising from such arrangements to be passed on to consumers¹⁴.

17. How do we ensure that the Solicitors' Code of Conduct takes priority over the interests of shareholders?

OFT recognises that particular safeguards would be necessary in order for law firms to operate properly but that such provisions are necessary for law firms operating under any business structure. How this is done can be determined by the authority entrusted with regulating such entities. One solution would be to appoint a Head of Legal Practice as envisaged in the Legal Services Act.

18. Would the abolition of the reserved areas provide the competition demanded by consumers while retaining the integrity of the solicitor profession?

The OFT is aware that reserving areas to legal professionals only is not universal; there are jurisdictions such as Finland where no reservation applies. Reservation can only be justified when it secures protection for consumers, for example by ensuring minimum standards of service that would not otherwise be available, and is proportionate to that end. The OFT supported the commencement of sections 25-29 of the Law Reform (Miscellaneous Provisions)(Scotland) Act 1990 which sets out arrangements by which rights to conduct litigation and rights of audience can be granted to bodies other than solicitors and advocates. We are not at present contemplating a further challenge to existing reservations but retain an open mind on the issue.

¹⁴ OFT's views on non lawyer ownership is set out in section 5 of its Response

19. Should legal professional privilege be available to the customers of practices where the owners and operators of the firm are not solicitors?

In the OFT report on Competition in Professions in 2001 and in its subsequent progress statement, the OFT highlighted the concern that where lawyers were in competition with non-lawyers, legal professional privilege might distort competition in favour of the lawyer. The OFT drew no conclusions as to whether protection for lawyers' clients might be decreased or whether that afforded to the clients of other professionals increased. The Government subsequently concluded that it would not be in the public interest to alter the scope of the privilege. This is therefore something for the Scottish Government to consider.

20. What, if any, requirements should be in place to protect solicitors' independence?

This is an issue to be determined by the authority entrusted with the regulation of such requirements.

21. What advantages or disadvantages do you see in the gradual or stepped introduction of alternative business structures?

The OFT agrees that the introduction of ABSs needs to be managed in a considered way especially where it is necessary to make regulatory changes. Reforms which attract a degree of consensus and raise less fundamental regulatory issues should be implemented more quickly.

However we are aware, and have received representations to the effect, that delay in implementing reform may place Scottish legal providers at a competitive disadvantage with their counterparts in England and Wales. It would also mean that securing the benefits to consumers of fewer restrictions on business structures would take longer. In some areas there should be opportunities for Scotland to move ahead with change more rapidly than in a larger jurisdiction.